MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 3, 2016/2017

BAC2644–CORPORATE FINANCE

(All sections / Groups)

30 MAY 2017
9.00 a.m–12.00 p.m
(3 Hours)

INSTRUCTIONS TO STUDENT

1. This Question paper consists of 6 pages with 4 Questions only.

2. Attempt all the **FOUR** questions. All questions carry equal marks and the distribution of the marks for each question is given.

3. Please write all your answers in the Answer Booklet provided.

QUESTION 1

Sharewin Bhd is a Malaysian listed company that deals with food and beverages. It has been in existence since year 1998. Its financial statements end at 31 December every year.

You have joined Sharewin in year 2012. As Sharewin's financial manager, you have been asked to evaluate two mutually exclusive projects (Project A and B) available. Sharewin has historically used a 4-year cutoff period for its projects. The required return is 11 percent.

Project A

Project A has an initial investment of RM70,000. Project A is expected to generate a cash flow of RM15,700 in year 1, RM18,300 in year 2. Thereafter, the cash flow is expected to grow by 10% every year until year 5.

Project B

On the other hand, Project B has an initial investment which is RM43,000 higher than the initial investment of Project A. Project B is expected to generate a cash flow of RM38,600 in year 1, RM35,000 in year 2, RM31,000 in year 3, RM28,000 in year 4 and RM25,200 in year 5.

Sharewin usually uses all possible capital budgeting techniques to decide which projects/investments to be invested.

Corporation tax

Assume that the corporation tax rate is 35%.

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Requirements:

a. As a financial manager, determine what should be your main goal. (2 marks)

b. What is the decision criteria for payback technique? (2 marks)

c. Determine the payback period for the two projects. (6 marks)

d. Determine the net present value for the two projects. (10 marks)

e. Based on your answers, which project would you choose? Why? (2 marks)

f. Under which circumstances is the Internal Rate of Return (IRR) unreliable? (3 marks)

(Total: 25 marks)

QUESTION 2

Isha Corporation was listed on the Bursa Malaysia on the 20th June 2015. Isha is involved is making small portable radios. Its sales has been increasing over the years.

Isha's balance sheet consists of current assets (cash, accounts receivables and inventory), fixed assets, current liabilities (accounts payable), long-term debt and equity.

Its income statement for year 2016 is shown below:

Sales	RM1,150,000
Costs	RM 750,000
Taxable income	RM 400,000
Taxes (40%)	RM 160,000
Net income	RM 240,000

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Isha paid a dividend of RM72,000 in year 2016 and expects to maintain the same dividend payout ratio in year 2017.

Isha Corporation's ending inventory and ending receivables in year 2016 are RM200,000 and RM160,000 respectively. Isha's year-end accounts payable in 2016 is RM75,000.

Cash account balance and fixed assets in year 2016 are RM10,000 and RM300,000 respectively. Isha had a long-term debt of RM250,000 in year 2016.

Isha Corporation's sales in year 2017 is expected to increase by 10%. Isha's costs, current assets, fixed assets and current liabilities are expected to increase proportionately with sales in year 2017.

Requirements:

a. Determine Isha's inventory period for year 2017. (5 marks)

b. Compute Isha's accounts receivables period for year 2017. (5 marks)

c. Determine Isha's operating cycle in year 2017. (2 marks)

d. Determine the External Financing Need (EFN) in year 2017. (13 marks)

(Total: 25 marks)

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QUESTION 3

Jashwin Snacks has been in the industry since year 2010. Jashwin's financial managers are always concerned about their project evaluation and capital structure.

Jashwin is considering a project with a cost of RM200,000. The project has a useful life of 5 years, and zero salvage value. It will be depreciated on a straight line basis. Jashwin's tax rate is 35%. As Jericho's financial manager, you have compiled the following information:

	Base case	Lower Bound	Upper bound
Unit sales	6,000	5,200	6,800
Price per unit	RM80	RM70	RM90
Variable cost per unit	RM50	RM40	RM60
Fixed costs per year	RM60,000	RM55,000	RM65,000

Jashwin currently is an all-equity firm with estimated earnings before interest and taxes of $80,000 annually forever. Currently, the firm has no debt but is considering borrowing $60,000 at 6.75 percent interest. The tax rate is 34 percent and the current cost of equity is 17.2 percent.

Requirements:

a. Determine the Net Present Value (NPV) of the project under the best case and worst case. (11 marks)

b. What is the value of the levered firm? (4 marks)

c. Determine the value of the levered firm if Jashwin's cost of equity decreases by 2 percent. (4 marks)

d. Jashwin's financial managers are considering a firm under three separate scenarios: 1) no debt, taxes or bankruptcy costs, 2) with debt and taxes but no bankruptcy costs, and 3) with debt, taxes, and bankruptcy costs. Under which one of these three scenarios will Jashwin have the highest value? (6 marks)

(Total: 25 marks)

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QUESTION 4

Santhev Corporation is listed on the New York Stock Exchange (NYSE). Being a multinational firm, Santhev is always on the lookout for investments abroad. Currently Santhev is looking at a new project in Malaysia. The project will cost RM7.5 million. The cash flows from the project are expected to be RM2.5 million per year for 5 years.

The current spot exchange rate is RM4 ringgits per US dollar. The risk-free rate in the US is 2%, and the risk-free rate in Malaysia 4%. The dollar required return is 15%.

Just as any other multinational firm, Santhev is very concerned about its risk management techniques. One way Santhev minimizes its risk is by buying options contract. Currently it holds a call option with an exercise price of $50 and a put option which has an exercise price of $30.

Futhermore, recently Santhev has also received a merger proposal from Devil Corporation. Devil Corporations plans to either acquire Santhev using stock or cash. Santhev's financial managers are trying to defend themselves using poison pill tactic.

Requirements:

a. Should Santhev invest in the new project in Malaysia? Explain your answer by showing all the relevant computations. (7 marks)

b. Determine the value of the call option at expiration if the stock price are as follows:

   i. $30 (2 marks)

   ii. $80 (2 marks)

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c. Determine the value of the put call option at expiration if the stock price are as follows:

i. $20 (2 marks)

ii. $45 (2 marks)

d. Explain the relationships among the reward-to-risk ratio, risk-free rate of return, market rate of return, market risk premium, beta, and the security market line.

(4 marks)

e. Identify the three factors that needs to be considered when choosing between stock and cash acquisition. (6 marks)

(Total: 25 marks)

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